BCA
Business Council of Australia

Submission to the inquiry into promoting economic dynamism, competition and business formation

March 2023

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1. Overview

The Business Council (BCA) welcomes the opportunity to provide a submission to the House of Representatives Standing Committee on Economics inquiry into promoting economic dynamism, competition and business formation.

A dynamic economy is one that has flexible and competitive markets and where labour and capital are highly mobile. This gives business stronger incentives to invest and innovate. A dynamic economy is also more open to the flow of people, capital and ideas from the rest of the world and is regulated in ways that lowers risk and increases certainty.

There is significant evidence that economic dynamism has fallen across the economy. This includes falling business entries and exits, sluggish business investment, slow uptake of innovation, and low labour mobility. A lack of dynamism impedes productivity and makes it harder for Australia to move to the frontier.

The likely causes of the fall in dynamism include a heavy regulatory burden, rising risk aversion, increased policy uncertainty, deteriorating housing affordability, a slower rate of globalisation and falling foreign direct investment. The actions of our competitors has also impacted investment, such as the United States with the Inflation Reduction Act and tax cuts in 2017 helping to draw investment away from the rest of the world

To a large extent, business drives dynamism in the economy through investment and innovation. Larger firms typically have higher productivity, pay higher wages and export more than smaller businesses.[1] Businesses could contribute more to dynamism if given stronger incentives such as a broad-based permanent investment allowance, reduced barriers to entry, greater policy certainty and a reduced regulatory burden. Other possible solutions to lift dynamism include better education and training, broad-based tax reform, increased housing supply, and a boost to migration.

Not all problems can be solved by changes to federal government policy – many policy levers are the domain of the states and territories. This raises the need for a coordinated approach to restore Australia's economic dynamism, including through existing institutional frameworks such as National Cabinet. Governments must ultimately come to terms with dealing with lower dynamism – both the symptoms and underlying causes.

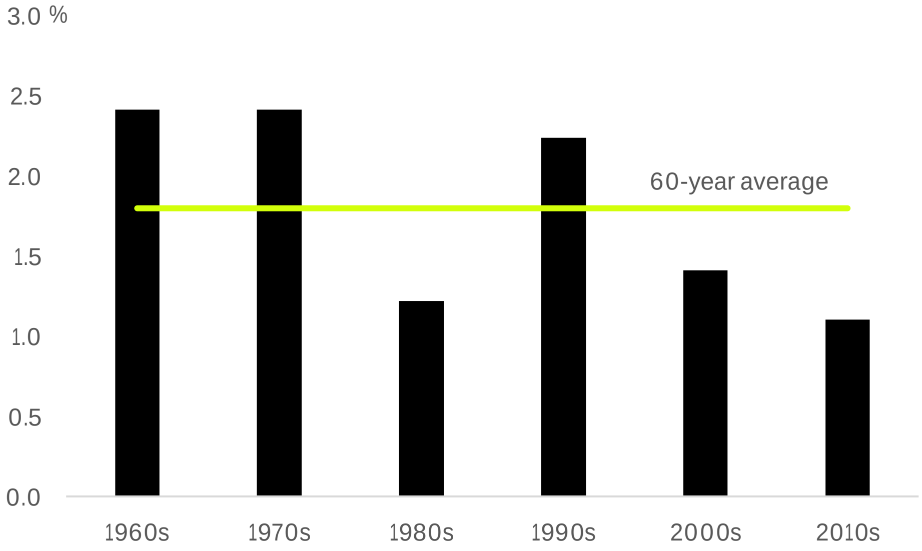
2. Lost dynamism – the evidence

There is considerable evidence to support the claim that Australia's economic dynamism is declining and is a drag on productivity. Our apparent loss of drive and agility helps explain why the Productivity Commission described the 2010s as Australia's worst productivity performance in six decades.[2] This is in stark contrast to average annual growth above 2 per cent a year during the 1990s. Lower productivity growth, in turn, helps to explain the persistence of sluggish growth in real wages.

The October Budget 2022-23 downgraded the long-run labour productivity growth assumption from 1.5 per cent to 1.2 per cent a year. This reflects the 20-year average annual growth rate through to 2018-19. But labour productivity has flatlined since COVID and the 20-year average has since slipped to just 0.9 per cent a year. The Productivity Commission also recently observed the 1.2 per cent productivity assumption may be difficult to achieve, particularly due to the growing services sector.

[1] The Australian Government the Treasury, 2017, *Analysis of wage growth*, November.
[2] Productivity Commission, 2023, *5-year Productivity Inquiry: Advancing Prosperity*, February.

Figure 1: Labour productivity growth by decade



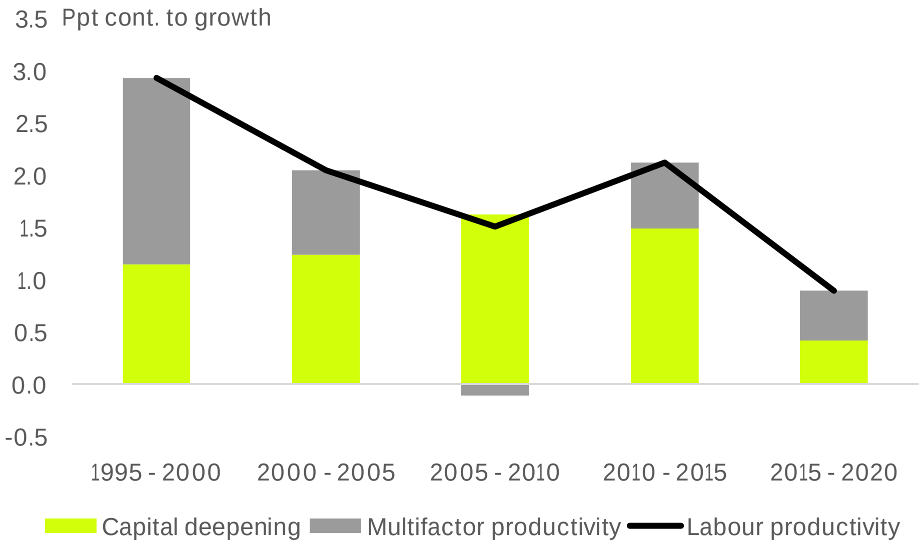
Source: ABS and Penn World Table

The core drivers of labour productivity are investment (capital deepening) and innovation (multifactor productivity). Each of these components have driven the recent weakness in labour productivity growth.

- **Capital deepening** (i.e. how much companies invest) growth has declined as total new business investment sits around recessionary levels as a share of GDP. It accounts for around two-thirds of labour productivity growth over the past 40 years, and around a third since Federation.
- **Multifactor productivity** (i.e. how innovative companies are) has barely grown over the past twenty years. It accounts for around two-thirds of labour productivity growth since Federation.

Multifactor productivity reflects how productively businesses combine both labour and capital inputs. It can be driven by factors such as new technology, new production processes and systems, better skilled workers, changes in management practices, and the efficient operation of enterprise bargaining.

Figure 2: Contributions to labour productivity growth by five-year period



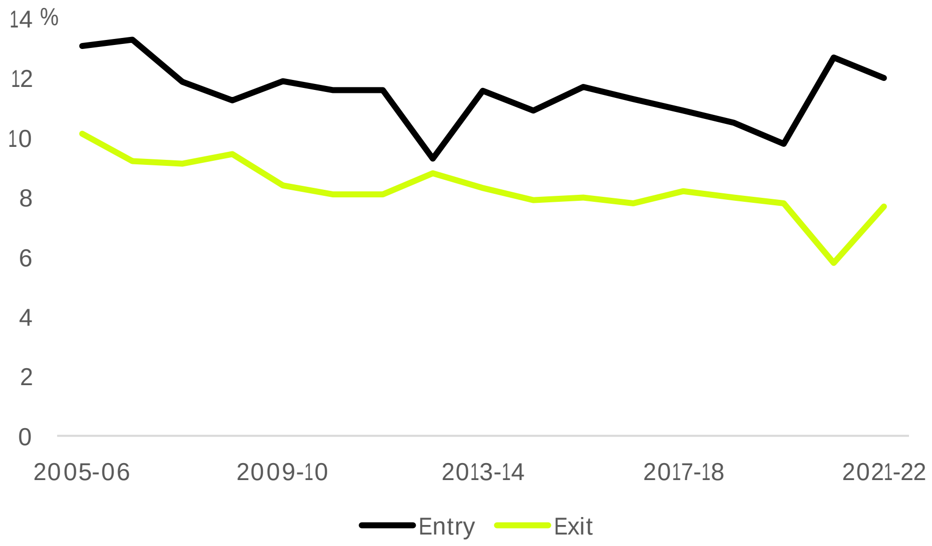
Source: ABS

2.1 Reduced business entries and exits

There has been a steady decline in new business entries and exits in Australia outside the pandemic. New firms tend to bring fresh ideas and new products, and typically are highly innovative. Conversely, the persistence of legacy firms could mean that less productive practices continue. This may not match the "zombie" firms of post-bust Japan-fame but is a troubling sign.

- *Firm entry rates* are lower now than almost two decades ago, although the recent trend has been improving, even after abstraction of the transport sector (e.g. ride share and delivery services). This may be a response to the pandemic (e.g. new firms related to COVID testing and vaccination) – further work is needed here.
- *Firm exit rates* have also been declining for almost two decades – in part due to declining entry rates. The rate is higher in the transport sector, with around 20 per cent of firms exiting in any one year. This may reflect the more transitory nature of parts of the gig economy (e.g. food delivery).

Figure 3: Business entry and exit rates for businesses with employees



Source: ABS

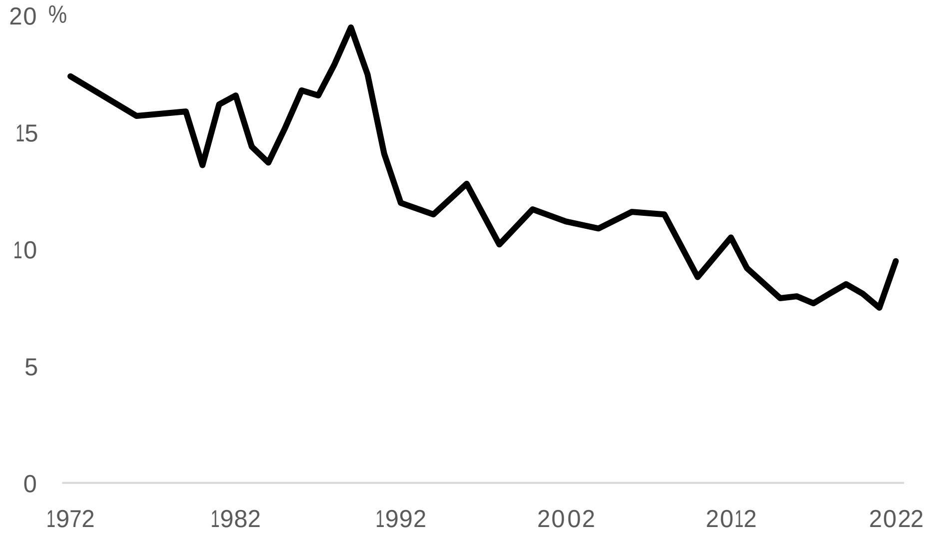
2.2 Slower rates of job switching

People switching jobs helps to ensure labour resources move to their most productive use and helps keep people happy and energised. There is a clear payoff here for society's wellbeing through improved mental health. The decline in job switching may be because of increased risk aversion. Some young workers may be stuck in less satisfying and unproductive roles ill-suited to their skills. But increasing risk aversion, partly owing to perceptions around job security, means these workers are reluctant to switch roles. Housing affordability may also be a factor impeding labour mobility.

Labour mobility has been steadily declining during the past 50 years. In 1989, a peak of around one in five workers had switched jobs in the past year. In 2022, the mobility rate had halved to around one in ten workers. Nevertheless, that was the highest rate in a decade and may reflect delayed switching due to uncertainty and interruptions during COVID. However, mobility does remain relatively low in the context of the tight labour market.

The decline in mobility has been broad based and has fallen for all age cohorts particularly since the Global Financial Crisis (GFC). The ageing population has also had an impact, as job mobility tends to fall as workers get older.

Figure 4: Share of workers who changed jobs the last year



Source: ABS

2.3 Slow adoption of new technology and innovation

Economic dynamism is facilitated by firms quickly adopting new practices and technologies, including from overseas. Inertia typically kicks in if adaptation is resisted. Australia ranks poorly on several metrics linked with innovation and frontier industries, including:

- Australia ranks a lowly 29th on the World Economic Forum's measure of adoption of information and communication technology, behind China, New Zealand and Russia.[3]
- Australian firms generally are slower to innovate, with Australia ranking 25th among the 132 economies featured in the WIPO Global Innovation Index.[4]
- A wide gap between frontier firms and others. Productivity in Australia's frontier firms has improved the past 15 years but has not kept pace with global frontier firms. Concerningly, the laggard firms in Australia have barely improved at all.[5]
- Only one Australian company (Atlassian) sits among the top 100 technology companies in the world.[6] This compares with 61 from the United States and 10 from China and implies low institutional investment in frontier industries.
- Investment in intangibles such as software, computer databases, research and development (R&D) etc has increased in Australia, from around 3 per cent to around 18 per cent of business investment over the past 60 years. However, Australia is an international laggard by most metrics when it comes to investment in intangibles. We have the second *lowest* share of intangibles investment in the OECD and the fourth slowest real growth rate over the past decade.
- The amount spent on R&D in Australia is below the OECD average. Less than 2 per cent of income is spent on R&D in Australia, compared with nearly 3 per cent across the OECD and more than 4 per cent in Korea and Israel.

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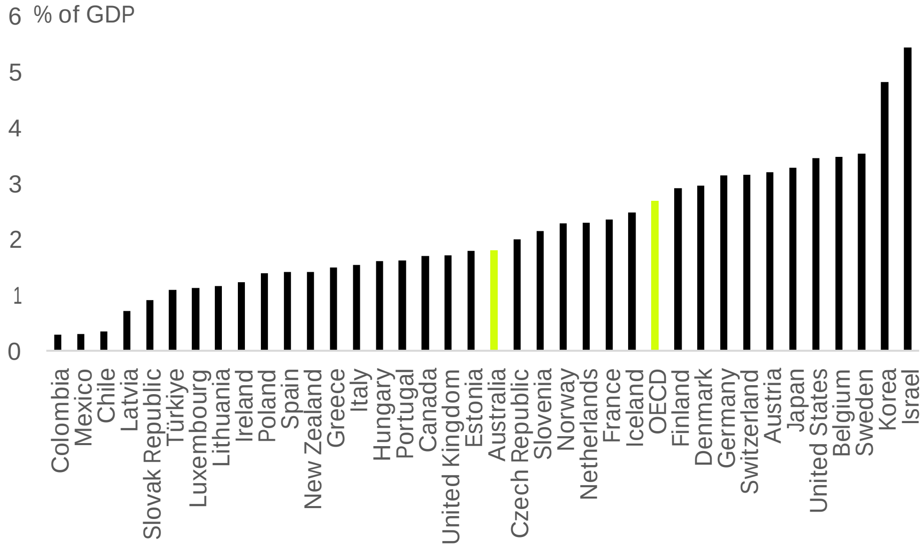
[3] Schwab, Klaus, (World Economic Forum) *Global Competitiveness Report 2019* https://www3.weforum.org/docs/WEF_TheGlobalCompetitivenessReport2019.pdf
[4] https://www.wipo.int/edocs/pubdocs/en/wipo_pub_gii_2021/au.pdf
[5] Andrews D, Hambur J, Hansell D & Wheeler A, 2022, *Reaching for the stars: Australian firms and the global productivity frontier*, February.
[6] https://companiesmarketcap.com/tech/largest-tech-companies-by-market-cap/, accessed 31 March 2023.

Figure 5: R&D investment across the OECD



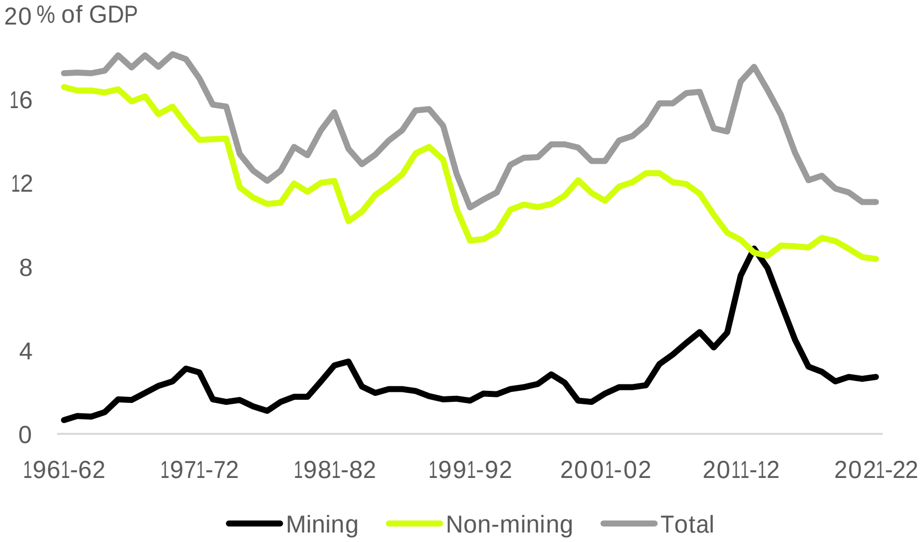
Source: OECD

2.4 Low business investment

Investment in new plant and equipment, technology and processes is an important part of fuelling dynamism. Yet, investment by non-miners in Australia has been falling as a share of GDP for the best part of six decades. Non-mining business investment has dwindled to around 8 per cent of the economy, compared with nearly 14 per cent in the late 1980s. The mining investment boom, in part, masked this underlying trend. Low business investment reflects both evidence of lost dynamism but is also a cause. The main symptoms are:

- *Slower growth in business credit.* Notwithstanding a recent uptick, business credit growth has been sluggish since the GFC. Businesses have been reluctant to take on credit to expand, invest and grow despite record-low interest rates.
- *High cash holdings* – Australian firms have been building up reserves of cash. This may be because of fears about the future and rising risk aversion. It also may be because firms lack clear investment opportunities and scale to invest accumulated capital overseas. Investment opportunities are analogous to options contracts, where the firm has the option, but not the obligation to invest. The option is valuable until such time as it is exercised. The firm's investment decision is the optimal time to exercise the option. When economic, political and policy uncertainty is high, the value of the option to invest in the future increases, delaying the decision to invest.

Figure 6: Business investment by industry



Source: ABS

3. Causes of dwindling dynamism

There may be less to worry about than this accumulation of evidence suggests. For example, there may be lags between the benefits derived from innovation and productivity, including higher wages. The tight labour market in Australia already shows evidence of increased job switching and accelerating wages growth. Higher wage costs should spur more investment too which could help ignite productivity growth.

Optimists also could point out that unlike after the GFC more than a decade ago, when dynamism also slumped, the balance sheets of corporates and households today are in better shape. Large cash balances mean there is plenty of "fuel" for new spending and investment should opportunities arise. The malaise is not uniquely Australian, either. Local solutions, then, may not be the answer, although public policy responses are needed to offset the secular trend.

The growth of the services sector also could be to blame. Australia's recent poor productivity outcomes certainly are a symptom of the steady growth of the services sector over recent decades. Services industries typically have lower productivity than industries like mining and productivity is more difficult to increase, particularly given the labour-intensive nature of the sector and difficulty in mass producing or automating service delivery. This will become a growing issue as services is 80 per cent of the economy and 90 per cent of the workforce – and growing.[7] That said, there are also other underlying causes of the symptoms of the loss of dynamism in Australia.

3.1 Rising risk aversion and cautious attitudes to risk

Rising risk aversion makes people less likely to switch jobs, move to another location or start a business. Similarly, firms may be disinclined to invest, innovate, hire new workers and otherwise be more creative if managers are worried about policy uncertainty and possible changes to their operating environment or global circumstances. There are a few possible explanations for the rise in risk aversion:

- *Social security adequacy* measured, for example, by a falling level of the unemployment benefit relative to wages. Perceived holes in the safety net may mean younger people are less likely to start their own business or move jobs. The cost of housing also has increased relative to incomes. Put another way, the cost of failure has become higher in relative terms.

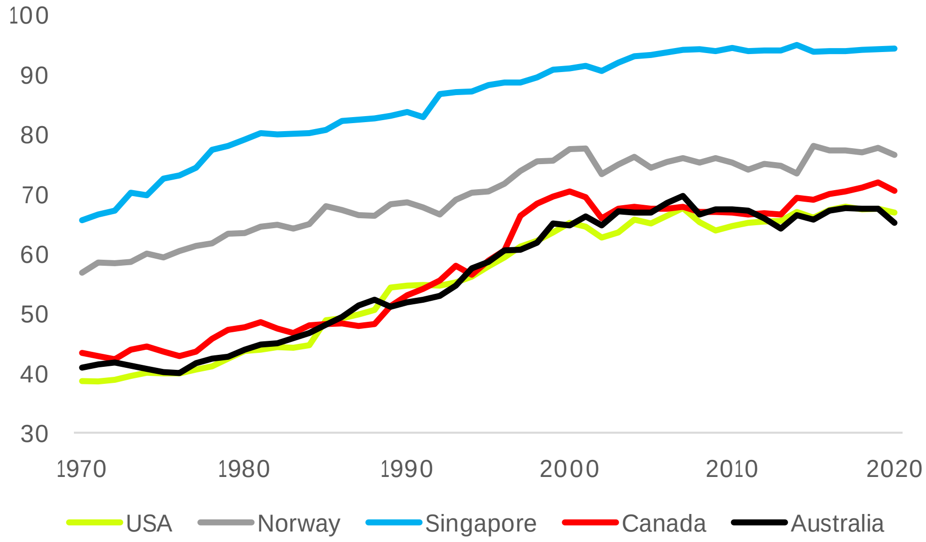
[7] Productivity Commission, 2023, *5-year Productivity Inquiry: Advancing Prosperity*, February.

- *The scarring effects of crises*, like the GFC and the pandemic. People typically become more risk averse during and after times of crisis, preserving cash and delaying decisions about employment and significant purchases. This phenomenon was evident after the GFC, and the COVID-19 pandemic may have triggered a similar effect.
- *An ageing population* largely due to improved life expectancy and low fertility, but also due to the loss of migrants during the pandemic. Rising incomes over time tend to depress fertility and extend longevity. Older people are less likely to take financial risks, pursue new ideas, develop new products, stay in the labour force, switch jobs, and start a new business. Less risk taking is likely to lead to lower productivity growth and economic growth. An analysis of population ageing across the United States over the period 1980 to 2010 found a 10 per cent increase in the share of population aged over 60 reduced the growth rate of GDP per capita by 5.5 per cent. Two-thirds of this reduction was due to slower growth in labour productivity, and a third was driven by slower growth in the labour force.[8]

3.2 Stalled globalisation

Australia is a small, open economy that benefited greatly from the steady rise in globalisation during the 1980s and 1990s. Globalisation was a key means to spread new ideas and innovative technology, culminating in the tech boom of the late 1990s. Since 2000, though, Australia's rate of globalisation has stalled. This stagnation coincides with the decline in productivity growth over the same period. Australia scores 65 on the KOF Economic Globalisation index (below the United States), around where it was in 2000. Singapore today scores 94, where 100 is the most globalised economy.

Figure 7: KOF Economic Globalisation index



Source: KOF Swiss Economic Institute

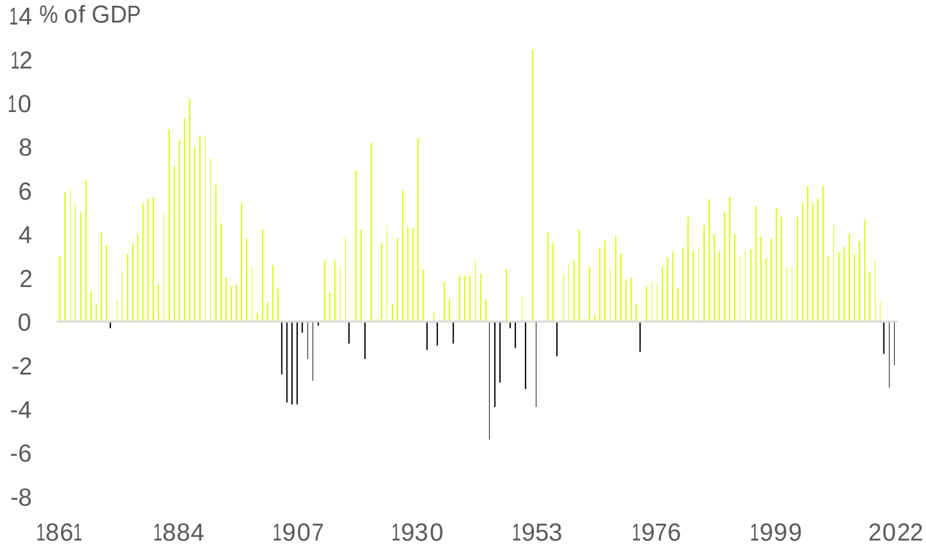
3.3 Foreign direct investment

Foreign investment brings not only new capital but new ideas and frontier technology. Australia was a net importer of foreign capital for the best part of the past twenty years, but now is a substantial net exporter of capital. The capital account, traditionally in structural surplus, has been in deficit for 14 of the past 15 quarters. The last time there was such an extended period of capital account deficits was in the 1940s. This reflects reduced investment demand in Australia relative to domestic saving, dwindling foreign investment into Australia and a flood of Australian capital overseas, where there are more opportunities. Many Australian firms (and, especially, superannuation funds) are seeking attractive investment opportunities outside Australia's small

[8] Maestas, N, Mullen K & Powell, D, *The Effect of Population Aging on Economic Growth, the Labor Force and Productivity*, NBER Working Paper No. 22452, 2016.

domestic market. Australian firms now invest more in the United States than United States firms invest in Australia.

Figure 8: Capital account balance



Source: ABS and Productivity Commission

3.4 Competition

Competition in markets encourages new entrants and threatens the survival of legacy firms that are not pushing to the frontier of innovation and creativity. In a competitive environment, these laggard firms either find a means to innovate and adapt – or fail. Australia's relatively low trade barriers, open approach to inbound investment, and generally sound business environment, make entry by new participants a real threat in most Australian industries. Digitisation and increasing globalisation have only reinforced this external competitive pressure.

There are some signs that market concentration has increased in Australia. For example, the average market share of the top four firms by industry has increased from around 41 per cent in 2001-02 to 43 per cent in 2019-20.[9] Treasury analysis also shows three quarters of the top-four firms in Australia are still in the top four after two years. The increased concentration is greater in industries less exposed to international competition.

Firms boosting their price mark-up over and above the rate needed to match the marginal cost of production can also be a sign of reduced competition and increased market power. Treasury analysis finds that average firm markups rose 6 per cent between 2003-04 and 2016-17 (later data is unavailable). However, there is evidence to suggest the increase in markups reflects changes in technology and investment, with faster growth in markups in digitally intensive sectors. This is because new types of investment have higher returns to scale, network effects and scalability.

High levels of concentration are not an issue in and of themselves. There is evidence that increased concentration over time reflects increased technology intensity, increased intensity of fixed operating costs, and is correlated with increased industry output.[10] Further, the degree of contestability – that is, the threat of entry or loss of market share – rather than current levels of market concentration, drive the intensity of competition. A market can be concentrated but still highly competitive if it is open and contestable and the switching costs are low for consumers. Economies of scale are also a feature of markets with high fixed costs, such as a for a geographically large country as Australia with a relatively small population spread across the country.

Key issues to consider when assessing competition in Australia include:

[9] Day I, Duretto Z, Hartigan P & Hambur J, 2022, *Competition in Australia and its impact on productivity growth*, Treasury Round Up, October.
[10] Kown S, Ma Y & Zimmerman K, 2023, *100 years of rising corporate concentration*, SAFE Working Paper No. 359.

- Barriers and threats to entry from new competitors – including from global competitors – which provide strong incentives for vigorous competition from incumbents.
- Domestic markets that appear less competitive or concentrated at first glance are likely to be much more competitive when considered, where appropriate, through a global lens.
- Increasing concentration may reflect more efficient firms increasing market shares by outcompeting other firms through better products, services, or processes.
- A focus on concentration tends to focus on narrow, historical market definitions reflecting current patterns of supply rather than the dynamic competitive process, such as likely or potential competitive constraints over time – including global competition and changes to technology.

Some fragmented markets may not generate the benefits of competitive rivalry that more concentrated markets do in terms of innovation in products and services. For example, the supply of various building trades is made up of many small firms (including tradespeople), as well as some larger firms. While the prices that tradespeople may be able to charge builders will vary with the building cycle, much of the innovation tends to come from suppliers or from the practices of larger firms.

Markets are also becoming more dynamic and globally integrated. Australian businesses are increasingly able to export into a broader range of markets and become part of global supply chains. Consumers can also more readily purchase from markets both globally and domestically. This means Australian businesses must be globally competitive to access global markets and to succeed in domestic markets.

Declining transaction costs and technology change are also breaking up value chains and driving disintermediation, with profound implications for business models. In these changing global markets, competition in a market is less about the number of local participants or the market share of the key players, and more about the conduct of participants within a market and the points of access for consumers.

3.5 Labour markets

The ratio of unemployed people to job vacancies is near record lows in Australia. This is an unprecedented outcome for Australia and indicates there is friction in the labour market. Many employers are unable to fill vacant roles with people with sufficient skills and workers seem less able to share in the benefits of growing the economy. The BCA has advocated for improvements in education and training to try and overcome these frictions. Moreover, improving entrepreneurial skills is essential if Australian businesses are to create more new enterprises in the industries of the future and move to the global frontier. A sustained rise in the migration intake is needed, particularly in skilled migration that taps global talent pools. The main symptoms are:

- *Mismatched workers*, with some workers reporting working in roles that do not adequately utilise their skills.
- *Poor education and training outcomes* despite a large increase in public funding (up 80 per cent in nominal terms over the past 12 years), our educational outcomes continue to slide, including on international Programme for International Student Assessment score rankings.
- *Fewer skilled migrants* due to the loss of migration during the pandemic has made the pool of available skilled labour even shallower than before. The increase in the annual migration intake for 2022-23 is welcome, but this will need to be sustained for several years to recoup the migrants lost during COVID.
- *The labour market has become more regulated*, with more restrictions and legislated barriers. Recent changes to industrial relations, including the restoration of multiemployer bargaining could lead to increased disruption and a less innovative and dynamic economy. Reforms to the Better Off Overall Test are welcome and will reduce the complexity of getting agreements that pay Australians more. Reserve Bank of Australia Governor Phil Lowe recently highlighted the importance of retaining flexibility in labour market settings.

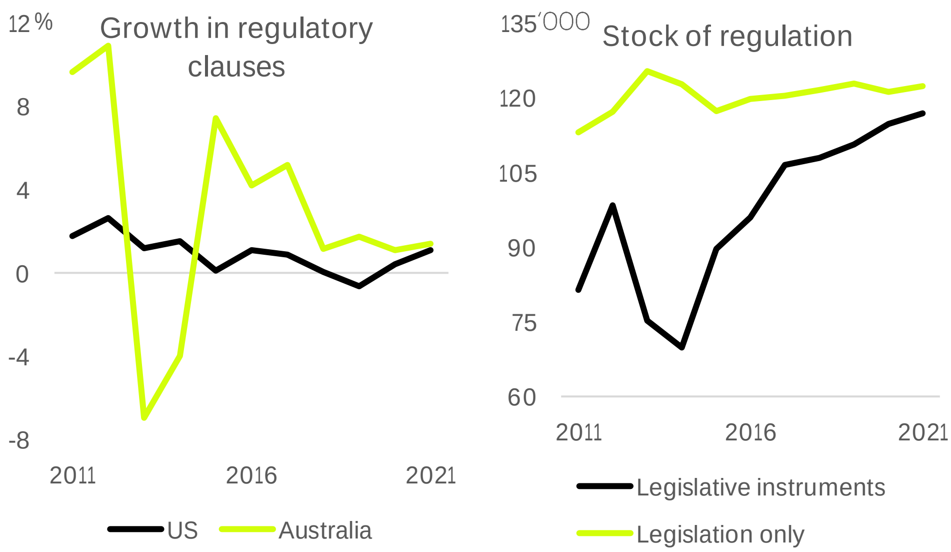
- *Limited career options for younger people* with the OECD finding around 40 per cent of Australia boys and around half of Australian girls expecting to work in one of the 10 most common jobs by the age of 30, including as a lawyer or doctor.[11] This could reflect young people receiving career advice that lacks creativity and guidance from parents, who are likely to work in those same professions.

3.6 Public institutions

Trust in Australian institutions according to the Edelman Trust indicator has been sliding as the regulatory burden has been increasing. That is, people have become more distrustful of the organisations becoming more intrusive in their lives and businesses. The heavier burden of regulation introduces friction into product markets that makes it harder for employees to innovate and for business managers to try new things. It also increases the administrative and reporting burden and can encourage rent seeking to gain advantage. Better process and transparency in government decision making will help turn around the decline in trust.

- *Heavy regulatory burden* with the number of restrictive clauses included in Commonwealth legislative instruments has increased over time. In 2021 there were more than 120,000 clauses regulating behaviour and changing incentives.

Figure 9: Growth in regulation and stock of regulation in Australia



Source: QuantGov

- *Policy uncertainty is rising* with the measure of policy uncertainty in Australia has exceeded the historical average of 100 level for much of the past 15 years. A similar trend is evident globally particularly since 2016, reflecting disruptions like Brexit, the election of President Trump, China's geopolitical interventions and the pandemic. Australia has suffered from these disruptions too, but perhaps our worse performance reflects the rotation of federal political leadership since 2010 and the implementation and subsequent unwinding of key policies in areas like climate change and industrial relations, among others.
- *High barriers to entry for new businesses*. Australia has become a more difficult place to do business. There is burdensome regulation and paperwork required across, and even within, governments. There are examples of regulation impeding new entrants, such as planning and zoning, and while welcome progress has been made, we (still) lack full implementation of automatic recognition of skills in different jurisdictions.
- *Poor policy processes.* For more than a decade, regulation and intervention are increasingly the first resort of policy makers to deal with a perceived market failure. Cost-benefit assessments of new policies either are by-passed or given mere lip service by governments. For example, over the past five years,

[11] OECD, 2020, *Dream jobs: Teenagers' career aspirations and the future of work*, January.

only one in six regulatory impact statements were considered 'best/exemplary practice'. Recent years have seen governments abruptly change the rules of the game, increasing risk premiums for future projects. There also has been a long line of 'one-offs' and measures that give broad scope and power for unnecessary and excessive interventions in business practices such as recent energy market intervention, the introduction of energy divestiture laws, critical infrastructure laws and the adjustment of the relative bargaining positions of firms (e.g. the News Media Bargaining Code). Businesses with the largest balance sheets have also been the target of ad hoc tax increases (e.g. royalty and payroll tax hikes), additional compliance measures, increased reporting, and additional/higher penalties. There has been excessive government reliance on ministerial discretion and less predictable, ad hoc decision making.

3.7 Housing

A lack of plentiful and affordable housing has meant people are less able to move to more desirable places of work in higher paying jobs. There is no point creating innovative and interesting jobs if workers are unable to find suitable and affordable housing as they move to new locations to take up these jobs. It is also a drag on national economic performance as it constrains productive capacity of some of Australia's most highly productive areas.[12] It is essential there be sufficient and affordable housing in the areas needed to attract and keep productive workforces. Planning reform at the state level is ongoing, but much more needs to be done more quickly.

- *Planning restrictions and zoning* mean we are not building enough housing in the right places to accommodate the growing workforce, particularly in Australia's major cities. Similarly, even if there is adequate housing, often there is insufficient infrastructure and services to entice workers from their existing (perhaps unsatisfying) employment.
- *Poor housing affordability* even outside Australia's major cities is an impediment to labour mobility. An extension of the worsening affordability is that many people have high housing debt, particularly first-time buyers. This heavy debt burden can contribute to even more risk aversion.
- *Stamp duties* imposed by state governments are inefficient taxes that impede labour mobility. People are less likely to move to more enjoyable and productive jobs if the upfront cost of buying a home, including stamp duty, is prohibitive.
- *Supporting infrastructure* is necessary for both greenfield and brownfield housing supply, including new or upgraded roads, transport, schools, hospitals, utilities, and green space. This substantial cost is one of the factors that delays or prevents new homes being built.

More can also be done to optimise labour mobility within a city given people's existing housing decisions by improving the adequacy and availability of connecting transport infrastructure.

There is evidence that high property prices can crowd out productive investment, lending for businesses, misallocate capital to unproductive investment and ultimately slow productivity growth. Physical assets (including land) provide collateral against which to borrow but the rise of intangibles means businesses that do not hold physical assets may find it more difficult to borrow to invest, expand and grow. This may be exacerbated by rising property prices with research showing firms in the United States with relatively high real estate holdings being less productive but able to borrow and invest more than firms with fewer holdings – despite being more productive.[13] Higher mortgage lending may also crowd out the lending capacity of banks for businesses to expand and grow, and in China there is evidence of high property prices also leading to reduced spending on R&D and the reallocation of managerial talent.[14]

[12] Hsieh, Change-Tai and Moretti, Enrico, 2019. *Housing constraints and spatial misallocation*, American Economic Journal: Macroeconomics Vol 11 (2).
[13] Sebastian Doerr, 2020. *Housing booms, reallocation and productivity,* BIS Working Papers 904, Bank for International Settlements.
[14] Hau, Harald and Ouyang, Difei,. 2019, *Local Capital Scarcity and Small Firm Growth: Evidence from Real Estate Booms in China*. CESifo Working Paper No. 7928.

3.8 Tax and regulation

Heavy tax and regulatory burdens have been handbrakes on investment and productivity. The problems with the tax system have been shown in multiple reviews. Tax is a major lever for governments to promote productivity growth.

Addressing issues such as the over reliance on direct taxation, the mismatch between federal and state taxes and spending, the volatile and inefficient state tax base, a globally uncompetitive tax rate for companies with turnover above $50 million, and fragmented payroll tax regimes all need to be on the table for reform. So too should be the heavy tax burden on incomes (both personal and business). There should be a coordinated approach by governments to reducing regulation and duplication.

3.9 Investment

There is too much friction in investment including the foreign investment screening regime. Investors wanting to bring innovation and investment to Australia face an increasingly formidable Foreign Investment Review Board process. Attracting the investment we need and protecting our security and sovereignty are not mutually exclusive.

Once through the door, investors are faced with duplication/inconsistencies across the federation, frequent changes to laws and regulations, and a poor understanding from policymakers and regulators of the complexity, time and cost to implement changes. Government regulation of foreign investment is necessary, but there also must be a focus on lowering the cost and making it easier for foreign entities to invest in Australia.

Despite our early success with developing the fundamental technology underpinning solar panels and Australians' enthusiasm for adopting these technologies (with the highest level of solar photovoltaic capacity per person of any country in the world[15]), China now makes 80 per cent of the world's solar panels. Australia missed out its chance to be at the leading edge of technology that will be fundamental to a transition to a net-zero economy.

Governments have invested in innovation hubs and precincts with mixed success. Enabling and encouraging businesses to work with the research community, including universities, to drive collaborative research needs a change in culture and attitude both in government and for businesses and the research community.

Consolidation and more focus is needed because there is much duplication of effort. Industry policy should be reviewed to embed an investment mindset rather than one-off grants.

4. A business-led framework for restoring dynamism

The dynamism, success and productivity of individual businesses are dependent principally on the actions and choices made by their managers and employees, within an environment influenced by government behaviour and regulation. Back in 2012, Gary Banks, Chair of the Productivity Commission, identified three main channels through which governments influence productivity:[16]

- *incentives* — external pressures and disciplines to perform well, such as competition policy
- *capabilities* — human capital, education systems, institutions and infrastructure to create productivity improvements within businesses
- *flexibility* — the ability to make the necessary changes, which can be impacted by regulation.

More than a decade on, but within this context of government influence, economists and commentators have advocated various remedies to reverse Australia's dwindling economic dynamism. Many, though, call for heavier

[15] The Australian Government the Treasury, 2021, *2021 Intergenerational Report*, June.
[16] Gary Banks, 2012, *Productivity policies: the 'to do' list*, November.

regulatory engagement in markets and industries, the so-called "dead hand" of more government intervention. One such suggested remedy was a further strengthening of competition policy in sectors where competitive pressures have waned. Others argue for punitive taxation of so-called "super profits", surpluses that are very unlikely to be sustained as commodity prices inevitably fall.

There is, however, an alternative, business-led approach that is likely to lead to more favourable outcomes. This approach involves creating an environment that unshackles and empowers the dynamism inherent in the corporate community and business leaders. This would be a means of releasing the constructive "animal spirits" that encourage private sector-led innovation, investment and hiring.

These positive forces can be unleashed via:

- *Encouraging creative leadership and entrepreneurialism* – stifling, heavy regulation makes it more difficult for business leaders to create productive new enterprises, innovate and hire. It can also raise barriers of entry or contestability for new firms or global competitors. It is important that Australia be made an easier place to do business, not harder. Moreover, it's important to maintain a flexible migration program to ensure Australian businesses have access to deeper global talent pools.
- *Improving corporate culture* – business leaders typically thrive when the culture of an organisation facilitates considered risk taking and encourages accountability. Enhanced culture is one way to overcome the creeping risk aversion currently stifling dynamism. There are well-publicised examples of where less than optimal cultures have encouraged poor corporate behaviour.
- *Increased corporate merger and acquisition activity* – such corporate activity helps facilitate the so-called creative destruction needed to ensure that resources – capital and labour – are deployed in the most productive fashion. Restrictions on such activity, while sometimes needed, often become heavy handed and can stifle this much needed reallocation of resources.
- *Innovation, automation and faster uptake* of technology – businesses must be able to quickly adopt and deploy new technology and practices as a means of innovation, particularly those coming from overseas. Most businesses recognise the benefits of genuine, constructive, long-term productivity measures that lead to both improved profits and higher wages for employees.
- *Looking outward/overseas* – businesses that have an export orientation and high overseas engagement tend to be larger and more productive. For all its strengths, Australia's local market is small by global standards, so outward looking businesses are more likely to prosper. It also means having easier access to global capital, skills, goods and services.

This business-led approach contrasts with the alternative practice of government and regulators punishing businesses for perceived transgressions, including via punitive taxation. As the Productivity Commission indicated, government has a crucial role to play in setting the necessary guard rails for corporate behaviour and providing the necessary incentives for businesses to invest and hire. After all, businesses doing the lion's share of both via long-term strategic decisions crave increased policy stability and predictability.

5. Concluding comments

The evidence of Australia's lost economic dynamism is clear – low rates of business turnover (both entries and exits), slower rates of job switching (despite very low unemployment), slow uptake of new technologies and sluggish business investment. This means our incentives to innovate and invest are weaker and that the economy is less open to global talent and frontier technology.

This troubling loss of dynamism helps to explain Australia's lousy productivity effort over recent decades, which the Productivity Commission describes as the worst in 60 years. It is no surprise, then, that wages growth, which in the long run moves closely with productivity growth, also has been sluggish.

There are many underlying reasons for this loss of economic dynamism. They include rising risk aversion, increased uncertainty (including over government policy), dwindling foreign investment (and inbound talent), a rigid and heavily regulated labour market, a heavy burden of tax and regulation, dwindling market competition, declining trust in institutions, and unaffordable housing.

None of these dynamism drags are insurmountable, but workable solutions will require coordinated responses from governments, business, trade unions and civil society. Only with sustained effort can Australia's economy move to the global frontier and grasp the exciting opportunities provided by emerging industries of the future.

Not all relevant public policy levers are within the control of the Commonwealth. State and territory governments have significant roles to play in making Australia an easier place to do business, invest, innovate and hire.

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